Argyle mine, located in the Kimberley region in the far north-eastern area of Western Australia

DIAMONDS
A not so shiny outlook

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Natural diamond production is on pace to be around 149 million carats in 2018, which compares to approximately 152 million in 2017, which was the highest annual output since the global financial crisis. 2018 will likely be the first year of a forecasted four-year period of consecutive annual production volume declines.

2019 will mark the first year without production from De Beer's Victor and Voorspoed mines, as both are planned for closure, representing a combined loss of over 1.2 million carats annually.

Looking forward to 2020, global production is forecast to decline further as Western Australia-based Argyle finally reaches the end of its long mine life and ALROSA's Russia-based Udachniy placers deplete. Argyle, which is expected to be completely closed by 2021, will represent one of the most significant diamond mine closures in history.

Argyle produced over 40 million carats annually in the 1990s, representing almost a third of global output volume. The mine, famous for producing smaller, brown diamonds, offset by world-class pink, violet and red diamonds, will leave a noticeable gap in supply of smaller stones which will alleviate a current oversupply in the category.

USD impacts

As of late-2018 the Indian rupee is at a historic low versus the dollar, down 13% year-to-date; the South African rand is down 16%; and the Chinese yuan is at a multi-month low. Further, the pound and euro are down 8% and 6%, respectively, versus the dollar in 2018.

This is in part due to idiosyncratic challenges associated with the nations listed above but also due to the fact that the US's Federal Reserve has raised the Fed Funds interest rate three times in 2018. A higher US interest rate tends to boost demand for dollars from abroad which are invested in fixed-income securities that yield a higher return. In addition, tighter monetary policy is indicative of a stronger economy, and a lower risk perception draws demand for US dollars intended for purchasing dollar-denominated assets.

The implication of a stronger US dollar on the diamond industry is varying. For example, a weaker South African rand tends to benefit miners that operate in rands and sell diamonds in dollars, such as De Beers Consolidated Mines and Petra Diamonds. However, a stronger dollar can also have a negative impact on the industry. For example, rough is more expensive in rupee terms for Indian diamond manufacturers and a higher dollar also tends to make diamonds relatively more expensive for non-US based end-consumers.

A moderate economic slowdown is

expected in the US in 2019 as the effect of the corporate tax cut in 2017 normalises and tighter monetary policy moderates corporate profitability. This could lead to a pause in the current higher-interest-rate-trajectory environment in 2019, which could lead to a weakening of the US dollar, which could lead to an increase in diamond demand outside of the US next year.

Lab-created diamond pricing

Even before De Beers announced that it would be entering the lab-created diamond jewellery space in May 2018 with the lowest-priced lab-created diamonds on the market, the price differential of equivalent lab-created and natural diamonds was widening significantly. The discount at year-end 2018 is 42% (a lab-created is 42% less than a natural) which is up from 29% in January 2018. This is primarily the result of more lab-created supply entering the market and lower-production costs resulting in more competitive pricing amongst producers.

However, the price of a mid-quality generic 1-carat lab-created diamond still sells for around $3 700 today, which compares to a 1-carat De Beers' Lightbox lab-created diamond at $800. So, while the price discount of a generic lab-created diamond has continued to come down relative to the price of a natural diamond, generic lab-created diamonds are still priced significantly higher than where De Beers' Lightbox lab-created diamonds are priced.

The operating margins of the lab-created producers are quite attractive at the current price points, so it's no wonder the industry is reluctant to come down to Lightbox-level pricing. But, as more competitors enter the space and more volume enters the supply chain it will likely become more difficult to maintain higher price levels while attracting sufficient consumer demand given where Lightbox lab-created diamonds are priced. MRA

The competition between real and lab-grown diamonds will continue in 2019

Image courtesy of www.123rf.com

ABOUT THE AUTHOR
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